

MANAGEMENT'S DISCUSSION AND ANALYSIS OF OPERATING RESULTS AND FINANCIAL CONDITION

The following is management's discussion and analysis ("MD&A") of the operating and financial results of the Ithaca Energy Inc. group of companies (the "Corporation" or "Ithaca Energy") for the year ended December 31, 2008. The information is provided as of March 26, 2009. The 2008 results have been compared to the results of 2007. All figures and the comparative figures contained herein are expressed in US dollars unless otherwise stated.

This discussion and analysis should be read in conjunction with the Corporation's audited consolidated financial statements as at December 31, 2008 and 2007 and for each of the years in the two year period ended December 31, 2008, together with the accompanying notes, and the December 31, 2008 Annual Information Form. These documents and additional information about Ithaca Energy Inc. are available on SEDAR at www.sedar.com.

This MD&A and any documents incorporated by reference herein contain certain forward-looking statements and forward-looking information which are based on the Corporation's internal expectations, estimates, projections, assumptions and beliefs as at the date of such statements or information, including, among other things, assumptions with respect to production, future capital expenditures and cash flow. The reader is cautioned that assumptions used in the preparation of such information may prove to be incorrect. The use of any of the words "anticipate", "continue", "estimate", "expect", "may", "will", "project", "plan", "should", "believe" and similar expressions are intended to identify forward-looking statements and forward-looking information. These statements are not guarantees of future performance and involve known and unknown risks, uncertainties and other factors that may cause actual results or events to differ materially from those anticipated in such forward-looking statements or information. The Corporation believes that the expectations reflected in those forward-looking statements and information are reasonable but no assurance can be given that these expectations, or the assumptions underlying these expectations, will prove to be correct and such forward-looking statements and information included in this MD&A and any documents incorporated by reference herein should not be unduly relied upon. Such forward-looking statements and information speak only as of the date of this MD&A and any documents incorporated by reference herein, as the case may be, and the Corporation does not undertake any obligation to publicly update or revise any forward-looking statements or information, except as required by applicable laws.

In particular, this MD&A and any documents incorporated by reference herein, contains specific forward-looking statements and information pertaining to the following:

- the quality of and future net revenues from the Corporation's reserves;
- oil, natural gas liquids ("NGLs") and natural gas production levels;
- commodity prices, foreign currency exchange rates and interest rates;
- capital expenditure programs and other expenditures;
- supply and demand for oil, NGLs and natural gas;
- the Corporation's ability to raise capital;
- the Corporation's ability to continually add to reserves;
- schedules and timing of certain projects and the Corporation's strategy for growth;
- the Corporation's future operating and financial results;
- treatment under governmental and other regulatory regimes and tax, environmental and other laws; and

- the start up of production at the Jacky field.

With respect to forward-looking statements contained in this MD&A and any documents incorporated by reference herein, the Corporation has made assumptions regarding, among other things:

- Ithaca's ability to obtain additional drilling rigs and other equipment in a timely manner, as required;
- future oil and natural gas production levels from Ithaca's properties and the prices obtained from the sales of such production;
- the level of future capital expenditure required to exploit and develop reserves;
- Ithaca's ability to obtain financing on acceptable terms; and
- the state of the debt and equity markets in the current economic environment.

The Corporation's actual results could differ materially from those anticipated in these forward-looking statements and information as a result of assumptions proving inaccurate and of both known and unknown risks, including the risk factors set forth in this MD&A and under the heading "Risk Factors" in the Corporation's Annual Information Form for the year ended December 31, 2008 (the "AIF") and the documents incorporated by reference herein and those set forth below:

- risks associated with the exploration for and development of oil and natural gas reserves;
- operational risks and liabilities that are not covered by insurance;
- volatility in market prices for oil, NGLs and natural gas;
- the ability of the Corporation to fund its substantial capital requirements and operations;
- risks associated with ensuring title to the Corporation's properties;
- changes in environmental or other legislation applicable to the Corporation's operations, and the Corporation's ability to comply with current and future environmental and other laws;
- the accuracy of oil and gas reserve estimates and estimated production levels as they are affected by the Corporation's exploration and development drilling and estimated decline rates, in particular the production rates of the Jacky field;
- the Corporation's success at acquisition, exploration, exploitation and development of reserves;
- the Corporation's reliance on key operational and management personnel;
- the ability of the Corporation to obtain and maintain all of its required permits and licenses;
- competition for, among other things, capital, drilling equipment, acquisitions of reserves, undeveloped lands and skilled personnel;
- changes in general economic, market and business conditions in Canada, North America, the United Kingdom, Europe and worldwide, specifically being the closing of the debt and equity markets to the Corporation during the current economic crisis;
- actions by governmental or regulatory authorities including changes in income tax laws or changes in tax laws, royalty rates and incentive programs relating to the oil and gas industry;
- adverse regulatory rulings, orders and decisions; and
- risks associated with the nature of the Common Shares.

Statements relating to "resources" are deemed to be forward-looking statements, as they involve the implied assessment, based on certain estimates and assumptions, that the reserves described can be profitably produced in the future. Many of these risk factors, other specific

risks, uncertainties and material assumptions are discussed in further detail throughout the AIF and in the MD&A. Readers are specifically referred to the risk factors described in the AIF under "Risk Factors" and in other documents the Corporation files from time to time with securities regulatory authorities. Copies of these documents are available without charge from Ithaca or electronically on the internet on Ithaca's SEDAR profile at www.sedar.com.

The information with respect to net present values of future net revenues from reserves presented throughout this discussion and analysis, whether calculated without discount or using a discount rate, are estimated values and do not represent fair market value. It should not be assumed that the net present values of future net revenues from reserves contained in this discussion and analysis are representative of the fair market value of the reserves. There is no assurance that the price and cost assumptions will be attained and variances could be material.

Barrel of oil equivalent (Boe) volumes are reported at 6:1 with 6 MCF = 1 Boe. All figures are in United States dollars unless otherwise noted.

BUSINESS OF THE CORPORATION

Ithaca Energy is an oil and gas exploration, development and production corporation active in the United Kingdom's Continental Shelf ("UKCS"). Exploration and development activities are focused on the Inner and Outer Moray Firth and the Central and Southern Gas Basin areas of the UKCS. The goal of Ithaca Energy, in the near term, is to achieve oil production from the development of existing discoveries on licences held by the Corporation, to originate and participate in exploration on licences held by the Corporation that has the potential of making significant contributions to future production, and to consider other opportunities for growth as they are presented to the Corporation. The Corporation is targeting first oil production from its 67.3% owned Jacky field to commence at or around the end of March, 2009. Production from its 66.7% owned Stella field is expected to commence in 2011, whilst development of its 52.3% owned Athena field is currently on hold pending a recovery in the oil price and the Corporation sees a price correction in the oil services sector.

The Corporation's common shares are listed for trading on the TSX Venture Exchange and the London Alternative Investment Market under the symbol "IAE"

OVERALL PERFORMANCE

2008 has been a year of exceptional market turbulence with volatile oil prices and the closing of both debt and equity markets for the smaller oil companies such as Ithaca Energy. The Corporation commenced the year seeking to close out the previously announced transaction to lease the Beatrice field from Talisman Energy (UK) Limited and Talisman North Sea Limited ("Talisman"), tie in the Jacky development and materially advance the development of the Athena field. The Corporation planned to fund this program through accessing both the equity and the debt markets. A new borrowing base debt facility through a syndicate of banks was intended to replace the existing Royal Bank of Scotland \$60 million Pre Development Facility agreed in November 2007 (the "RBS Facility").

As a direct result of the market conditions, the Corporation altered its development program, prioritising the Jacky development. During 2008, the Corporation succeeded in:

- Drilling four wells, compared with two wells in 2007. There was one well drilled in 2006 and no drilling activity in 2005 or 2004. In January 2008 Ithaca drilled the Polly prospect and then in February 2008 the Manuel prospect, both located in the Beatrice area. On March and April 2008 the Corporation drilled the Athena 14/18-17 well and in June and July, 2008 drilled the 14/18b well also located in the Athena field;
- Raising C\$75 million in equity through a public offering in August 2008;
- Completing the acquisition of an interest in the Stella and Harrier fields in August 2008;
- Substantially strengthening the balance sheet through a transaction with Dyas (UK) Limited in October 2008, whereby 25.25% of the Corporation's portfolio was sold for a consideration of £40 million and the RBS Facility was replaced with a US\$61.2 million two year convertible facility (the "Dyas Transaction"). In addition to supplying finance to achieve the Corporation's objectives, this transaction provided Ithaca Energy with a well financed strategic partner across the Corporation's portfolio and strengthened the Board of the Corporation with the appointment of the Managing Director of Dyas BV;
- Closing the Beatrice acquisition in November 2008 and subsequently reducing operating costs whilst sustaining higher rates of production;
- Obtaining Field Development Plan approval for the Jacky development in November 2008 with production targeted for the end of March, 2009; and
- Completing the sale of the Corporation's interest in the non core Barbara field in November 2008 for consideration of \$8.25 million.

Ithaca Energy exited 2008 in good financial condition. The Corporation had free cash balances of \$26.9 million at year end as a result of the recently completed Dyas Transaction and from an issue of 50 million common shares, which closed in August 2008 and raised net proceeds of approximately \$67 million. Total cash including funds posted as collateral in support of certain cash backed bank letters of credit was \$39.2 million. It is anticipated that these restricted funds will be released by the bank in mid 2009.

The table presented below reviews the actual application of proceeds raised from the previous four share issues as compared to the forecast application of proceeds at the time of each of the equity issues.

Nature of Expense \$M	Equity funds raised from May 2006 to Nov 2007	Equity issued Aug 11 2008	Total Equity raised	Application of proceeds	Variance
Barbara Project Development	6,800	-	6,800	6,600	200
Athena Project Appraisal and first and second phase of Field Development Plan	82,196	16,991	99,188	95,066	4,122
Beatrice Alpha North (Jacky) Project appraisal and first phase of Field	11,892	-	11,892	26,000	(14,108)

Development Plan					
Acquisition of Beatrice and Stella	-	42,951	42,951	28,803	14,147
Exploration Program	35,315	-	35,315	53,079	(17,764)
Geological and Geophysical, General and administrative expenses, and general corporate purposes	4,401	-	4,401	10,084	(5,683)
Undesignated expenditure and working capital requirements	51,928	6,608	58,536	68,253	(9,717)
TOTAL	\$192,532	\$66,550	\$259,082	\$259,082	

The under-spend on the Athena field reflects the Corporation's decision to suspend the development of the Athena project. With respect to the Beatrice acquisition, an agreement was reached with Talisman to defer the payment of the consideration until such time as the Jacky field enters into production. The consideration is then to be paid in four equal monthly instalments from the date of commencement of the Jacky production. The additional funds arising from these positive variances have been applied to completing the Jacky development. It was anticipated at the time that these equity funds were raised that the remaining Jacky development costs would have been met from new bank borrowing. The negative variance on the exploration program is due to the decision to drill the Manuel prospect in order to take advantage of favourable rig contractual terms following the drilling of the budgeted Polly prospect.

Property, plant and equipment increased from \$117.0 million at December 31, 2007, to \$296.5 million at December 31, 2008, as analyzed below:

Area \$M	2008	2007
Inner Moray Firth	152,375	34,949
Outer Moray Firth	119,642	68,737
Central North Sea	19,079	8,885
NW Core	2,117	2,541
SE Core	2,527	1,564
Office Equipment	783	288
Total	\$ 296,523	\$ 116,964

The material increase in the Inner Moray Firth and Outer Moray Firth relates to the four wells drilled in 2008, two in each of the Beatrice Area and Athena field.

Current liabilities increased from \$17.9 million at December 31, 2008, to \$41.1 million at December 31, 2008, which was comprised entirely of accounts payable and accrued liabilities. This increase is a reflection of the level of activity underway at the year end associated with the Jacky field development and the drilling of the Carna exploration well. These amounts have largely been settled post year end with the balance being the Beatrice deferred lease premium and the proportionate proceeds from the first oil sale post the Beatrice transaction due to Talisman relating to oil produced prior to the closing of the Beatrice transaction, payable in the second and third quarters of 2009. The Corporation had secured debt of \$61.2 million as at December 31, 2008 and no debt in 2007. Working capital was lower at December 31, 2008 at approximately \$19.7 million versus \$91.3 million at December 31, 2007, with the high balance at the 2007 year end being due to a C\$100m equity issuance that had closed in the month of

November. The increase in share capital, shareholders equity and common shares outstanding reflects the equity financing that closed in August 2008.

The 2008 net loss before income taxes increased to \$30.1 million from \$2.3 million in 2007. The increase in net loss is primarily due to: the amortization of the fees associated with the RBS Facility that was repaid during the year; operating costs of the Beatrice facility; loss on foreign exchange being largely the devaluation of British Pound cash balances held during the year against a strengthening US Dollar; loss on a US Dollar/Euro forward contract as a result of the strengthening US Dollar; and increased expenses relating to stock based compensation awarded during the year.

Cash flow from operations was negative in 2008, as in 2007. Negative cash flow from operations resulted from the Corporation's activity levels in the North Sea, including the operations of the Beatrice facility, and the commensurate overheads related to these activities. Oil production from Jacky is anticipated to commence on or around the end of March 2009 and is therefore expected to reverse this trend. Management has actively looked to reduce Beatrice operating costs since taking over the facilities. Material changes have included: improved terms for equipment storage and supply vessels; reduction in non operational manning on Beatrice facilities; and the renegotiation of electricity supply contracts amounting to an annual cost savings of approximately \$3.9 million.

Sproule International Limited (Sproule) prepared an independent engineering evaluation, at December 31, 2008, which adheres to the NI 51-101 standards for reserve volumes and values. Total Proved plus Probable plus Possible reserves, net to the Corporation's interest, were 54.97MMBoe at December 31, 2008 (2007: 39.36MMBoe) representing a 40% increase year on year representing the additions of the Beatrice and Stella fields as adjusted for the Barbara disposal (transacted at \$10.17/boe based on a Sproule report effective 31 May 2008) and the Dyas Transaction (transacted at \$6.56/boe based on a Sproule report dated 31 May 2008).

Total Proved reserves, net to the Corporation's interest and relating entirely to the Beatrice and Jacky developments were 2.2MMBoe at 31 December, 2008 (2007:12.60MMBoe) and included 0.69MMBoe of developed producing (2007: Nil) and 0.96MMBoe of developed non-producing (2007: Nil). A further 7.69MMBoe of Proved reserves were attributed to the Athena field and 4.61MMBoe to the Stella field. Total Probable reserves, net to the Corporation's interest, at December 31, 2008 were 14.22MMBoe compared to 13.66MMBoe at December 31, 2007, Total Proved and Probable reserves net to the Corporation's interest at December 31, 2008 were 28.74MMBoe compared to 26.26MMBoe at December 31, 2007 being an increase year on year of 9.5%.

Possible reserves net to the Corporation's interest, at December 31, 2008, were evaluated by Sproule to be 26.22MMBoe (2007: 13.09MMBoe) largely being the addition of the Stella field.

Sproule evaluated the commerciality of the pools at December 31, 2008 and calculated net present value of the Corporation's reserves net to Ithaca's interest, discounted at 10% per annum. All values were computed using forecast prices and costs.

US\$MM NPV ₁₀	Proved		Probable		Possible	
	2008	2007	2008	2007	2008	2007
Before tax	150.09	110.27	399.66	327.44	784.61	353.8
After tax	145.16	63.31	212.54	163.84	394.83	179.5

Complete disclosure of the Corporation's reserves as reported under the guidelines of NI 51-101 can be found on SEDAR at www.sedar.com.

Ithaca Energy's primary focus in 2009 will be the bringing on-stream of its 67.3% owned Jacky field, the appraisal of its 49.8% Stella field, and maximising the production and efficiency of its 74.8% Beatrice facility all within the means of the Corporation's current capital structure. In addition, the Corporation has continued its UK North Sea exploration program, having drilled its 29.9% owned Carna prospect in the first quarter of 2009. The Corporation has set a capital budget of \$60.2 million to complete its 2009 development, appraisal, and exploration program which include the drilling of two wells (one exploration and one appraisal) on the Corporation's prospects, the completion of the Jacky development and the tie in of the Beatrice Bravo platform.

Ithaca Energy has been able to execute its business plan for the UK North Sea in large part by its ability to access capital through the issuance of equity and through the successful divestment of assets:

- On April 4, 2008, the Corporation signed a \$60 million Senior Secured Credit Facility with the Royal Bank of Scotland in support of the Jacky and Athena developments. This was fully drawn over the year and refinanced on 31 October 31, 2008 by the Dyas Transaction (described below).
- On August 11, 2008 the Corporation successfully marketed, 50,000,000 common shares at a price of CAD\$1.50 per common share for gross proceeds of CAD\$75 million. Shortly thereafter the equity markets effectively closed to oil companies comparable to the Corporation.
- On October 31, 2008 Ithaca entered into a Sale and Purchase Agreement (the "Dyas Transaction") with Dyas UK Limited ("Dyas") for the sale of a portion of its interests in all of its oil and gas licences and the provision of a convertible loan facility. The Dyas Transaction provided that Dyas would purchase 25.25% of Ithaca's interests in all assets owned by the Corporation for the consideration of £40 million cash (approximately US\$65.6 million) with an effective date of November 1, 2008. Dyas advanced this sum to Ithaca as a loan until closing of the transaction at which time the consideration would be repaid and the loan would become immediately repayable.

In addition, Dyas provided Ithaca with a senior secured loan (the "Dyas Facility") with which to redeem in full the fully drawn Royal Bank of Scotland US\$60 million Predevelopment Facility. The Dyas Facility has a margin over US Dollar Libor of 4.5% and an initial term of two years. The loan is extendable by Dyas in two one-year tranches should the oil price average less than US\$60 per barrel in the previous year, giving Ithaca an extended credit facility.

Dyas UK Limited has the option at any time during the subsequent two years (or up to the end of the extended period is applicable) to acquire an additional 15.15% of the Corporation's portfolio held as at the effective date, for a consideration of \$61.2 million, adjusted for working capital movements in the intervening period. In the event that the option is exercised, then the \$61.2 million outstanding loan facility would become immediately due and payable, and the consideration would then be applied to meet this obligation in full.

On December 17, 2008 the Dyas Transaction partially completed with all the interests other than that relating to the Stella field having been transferred. As a consequence the consideration paid on the partial completion was adjusted to £35 million with the balance of £5 million payable upon the transfer of the Stella interest. The drawn amounts on the £40 million tranche of the Dyas Facility were repaid and the amount available to be drawn under this portion of the loan was reduced to £5 million. The transfer of the interest in the Stella property is expected to complete in late March or early April 2009.

- The 20% (6.7% expected unitization) interest in the Barbara gas field was disposed of for \$8.25 million on November 14, 2008 as it was considered to be non core to Ithaca (the “Barbara Disposal”).

Significant capital will be required to further the Corporation’s anticipated development activities in 2009 and 2010 and these are expected to be met through a combination of existing cash resources, production from the Beatrice and Jacky fields and selective farm-outs. The Corporation has budgeted for its future capital spending plans assuming no new funds from equity or debt markets.

Non Binding Proposed Offer from Endeavour

On June 20, 2008 Ithaca confirmed that it had received an unsolicited non-binding proposed offer (the “Non-Binding Proposed Offer”) from Endeavour International Corporation (“Endeavour”) to acquire the entire issued share capital of Ithaca for a combination of cash and shares at an indicative price of US\$3.25 per Ithaca share. On July 7, 2008 the Corporation announced that the Board had unanimously decided that the unsolicited Non-Binding Proposed Offer was not in the best interest of shareholders. On July 7, 2008 Endeavour withdrew its Non-Binding Proposed Offer.

25th Round Awards

Ithaca UK was offered six new license areas in the 25th licensing round. The offers of awards covered: Northern North Sea blocks 3/3b, 211/11b, 211/16b (all Ithaca UK as operator at 35% and, under a bidding agreement paying 50% of all work up to and including the end of the first well in each of the two areas and increasing to 42.5% working interest after this obligation is met); Central North Sea blocks 29/4b and 29/5e (Ithaca UK 100% and operator); block 29/10b (Ithaca UK 50% and operated by Maersk Oil and Gas); Southern North Sea blocks 43/28 and 43/29 (Ithaca 30% and operated by Venture). Ithaca will discuss these offers with its potential partners and DECC prior to accepting any of the offers in 2009. Upon acceptance, the discrete licenses would then be awarded by DECC.

SELECTED ANNUAL INFORMATION

The consolidated financial statements of the Corporation and the financial data contained in the MD&A are prepared in accordance with Canadian Generally Accepted Accounting Principles (“GAAP”). The consolidated financial statements include the accounts of Ithaca Energy Inc. and its wholly-owned subsidiary Ithaca Energy (UK) Limited. All inter-company transactions and balances have been eliminated on consolidation. A significant portion of the Corporation’s North Sea oil and gas activities are carried out jointly with others. The consolidated financial statements reflect only the Corporation’s proportionate interest in such activities.

The Corporation's reporting currency is US dollars ("\$\$"); unless indicated otherwise, all amounts are presented in US dollars. The accounting records of Ithaca Energy (UK) Limited are likewise maintained in US dollars.

US \$	2008	2007	2006
Trading Revenue	2,472,106	-	-
Net loss	30,446,967	2,328,571	4,306,335
Net loss per share	0.23	0.02	0.09
Net loss per share diluted basis	0.23	0.02	0.09
Total assets	357,670,361	226,142,544	114,934,154
Total long-term liabilities	72,744,703	4,716,475	1,513,000

SUMMARY OF QUARTERLY

RESULTS OF OPERATIONS

The Corporation generated its first operational revenue following the acquisition of the Beatrice facilities, completed on November 11, 2008. During the period to year end production averaged 1,152 boepd (58,720 boe) and at an average realised price of \$42.10 per barrel.

Ithaca Energy Quarterly Results

	31-Dec-08	30-Sep-08	30-Jun-08	31-Mar-08	31-Dec-07	30-Sep-07	30-Jun-07	31-Mar-07
REVENUE	\$	\$	\$	\$	\$	\$	\$	\$
Oil Sales	2,472,106							
Interest income	143,441	160,635	126,137	379,350	455,865	355,920	177,232	348,604
COSTS AND EXPENSES								
General and administrative	3,287,190	1,954,388	1,680,204	1,675,593	2,795,777	989,702	1,527,583	722,685
Loan Fee Amortization	1,194,497	2,339,082	135,312	-	-	-	-	-
Loss on Financial	1,777,181							
Operating	4,587,834	-	-	-				
Depreciation and accretion	2,076,311	249,794	278,838	206,540	261,560	84,211	51,156	58,898
(Gain) Loss on foreign exchange	7,739,985	648,805	(447,527)	3,997,151	(230,551)	(296,583)	(1,988,448)	(309,798)
NET PROFIT / (LOSS)	(18,047,451)	(5,031,434)	(1,520,690)	(5,499,934)	(2,370,921)	(421,410)	586,941	(123,181)
TAXES	347,458	-	-	-	-	-	-	-
NET PROFIT / (LOSS) AFTER TAX	(18,394,909)	(5,031,434)	(1,520,690)	(5,499,934)	(2,370,921)	(421,410)	586,941	(123,181)
NET PROFIT / (LOSS) PER SHARE	(0.14)	(0.04)	(0.01)	(0.05)	(0.02)	(0.00)	0.01	0.00
Deficit, beginning of period	(19,892,517)	(14,861,083)	(13,340,393)	(7,840,459)	(5,469,538)	(5,048,128)	(5,635,069)	(5,511,888)
Deficit, end of period	(38,287,426)	(19,892,517)	(14,861,083)	(13,340,393)	(7,840,459)	(5,469,538)	(5,048,128)	(5,635,069)

The Corporation had a net loss before taxes of \$30,099,509 for the year ended December 31, 2008 as compared to a net loss of \$2,328,571 for the year ended December 31, 2007. This increase in net loss was driven by: the accelerated amortisation of the fees for the RBS Facility of \$3,668,891; foreign exchange losses in the year of \$11,938,414 being largely unrealised losses arising from the conversion of the Canadian Dollar proceeds from the August equity issuance being converted to British Pounds, and the British Pounds consideration for the Dyas Transaction during a period of substantial strengthening of the US Dollar; and increased stock based compensation expenses totalling \$3,529,252. Additionally the acquisition of the producing Beatrice facility led to operating costs of \$4,587,834 and depletion expenses of \$2,811,483. General and administrative fees and bank interest were in line with the previous year.

Interest income in the periods under review resulted from interest on bank accounts and short-term deposits, as the Corporation had high cash balances from the equity offerings and the Dyas Transaction. The proceeds from the November 2007 equity issue was held in Canadian Dollar bank accounts and as a result of the strengthening US Dollar the Corporation realised a foreign exchange loss in the second quarter as these funds were converted to meet US Dollar expenses. In March 2008, the Corporation's Board approved a hedging policy to manage foreign exchange risks. Subsequently the Corporation entered in to a forward US Dollar to Euro exchange rate contract with the Royal Bank of Scotland to mitigate exchange rate movements associated with the Jacky platform costs. This contract was hedged through a forward contract at a weighted average rate of 1.568:1 and expired in December 2008. In March 2009, a further exchange rate contract was entered in to with the Bank of Scotland to hedge over 90% of its known British Pound expenditures for 2009 from mid April onwards, see "Post Year End Results". The foreign exchange losses in the final quarter of 2008 reflect the strong appreciation of the US Dollar versus the British Pound over this period, with the losses being the revaluation of British Pound cash balances held at year end to meet near term anticipated British Pound expenditures, such as costs relating to the Jacky development.

The Corporation issued stock options to Directors and employees in February, September and December 2008, which resulted in a stock based compensation charge of \$3,529,252. The total charge for options in 2007 was \$1,109,396.

General and administrative expenses increased in 2008 versus 2007 reflective of the Corporation's increased activities year on year. As in 2007 and prior years, the Corporation continued its compensation policy of combining share options with competitive salaries and benefits packages to attract the best qualified staff. The Corporation continued to issue share options during the year as its share equity base expanded and as it added new employees. The Corporation intends to review the ongoing share option program annually against market conditions.

US \$	2008	2007
Staff costs	6,270,990	4,458,863
Stock compensation expense	3,529,252	1,109,396
Office costs and other administrative expenses	6,214,226	4,581,848

Less - capitalized overheads	7,662,576	4,114,360
TOTAL	8,351,892	6,035,747

Activity Summary in the UK North Sea

Greater Beatrice Area

On January 14, 2008, Ithaca commenced drilling on its 100% Polly Prospect on Block 12/26c near the Beatrice oilfield in the Inner Moray Firth area of the United Kingdom's continental shelf. On January 23, 2008, the Corporation successfully completed a farmout of an interest in its Polly prospect. North Sea Energy Corporation agreed to pay 30% of the dry hole costs of drilling the Polly well, drilled in the Inner Moray Firth area, in consideration of which, it earned a 20% interest in block 12/26c which is a portion of Ithaca's 100% owned License P. 1392. The resulting interests in the well and prospect were Ithaca 80% and North Sea Energy Corporation 20%. Post the Dyas Transaction the Corporation's interest was further reduced to 59.8%. The well has been suspended for future evaluation having encountered oil in the Beatrice Sandstone and the discovery will be considered for further activity when ranked with other upside opportunities in the Beatrice area

On February 11, 2008, Ithaca commenced a well on the Manuel prospect in block 11/29 which is 12 kilometres west of the Beatrice field. Net costs to the Corporation were reduced through several farm-out agreements with third parties such that Ithaca paid 52.5% for an 81.73% retained interest (reduced further to 61.09% post the Dyas Transaction). The well encountered oil saturated sands of Jurassic age of less than reservoir quality.

Jacky

The 67.28% Jacky field received Field Development Plan approval from the Department of Climate Change ("DECC") on November 10, 2008. First production is currently expected on or around the end of March 2009 at an anticipated 2009 gross rate of 7,500 bopd.

Beatrice

On November 10, 2008 Ithaca announced that it had closed a deal to lease 100% of the Beatrice oilfield and Nigg Terminal (net 74.75% following completion of the Dyas Transaction) from Talisman for a minimum of 3 years, extendable at Ithaca's election for the duration of production, in consideration for the sum of £10 million (approximately US\$16.5 million at the time). After cessation of production Beatrice will be returned to Talisman who will conduct decommissioning and abandonment of the facilities. Ithaca has appointed Wood Group Engineering (North Sea) Limited to be the Duty Holder for the Beatrice facilities under UK offshore regulations.

Included in the Beatrice transaction are the offshore facilities of three platforms, Alpha, Bravo and Charlie, operatorship of the Nigg onshore storage and trans-shipment terminal and a 16 inch diameter pipeline from the Alpha platform to the Nigg facility.

The acquisition of the Beatrice field provided Ithaca Energy with its first oil production and control of the infrastructure in the area.

The Corporation entered in to a sales agreement with BP Oil International Limited (“BPOIL”) on December 23 2008 to market the Beatrice and Jacky crude oil through to December 31, 2009, extendable by mutual consent for a further year. This agreement prices the monthly production against set benchmarks resulting in regular payments, irrespective of when BPOIL elects to lift the oil from the Nigg tanks. Under a separate transaction, the Corporation has agreed to lease the spare Nigg oil tanks to BPOIL for a fixed monthly payment for a term of one year.

Athena

On March 10, 2008 Ithaca commenced a well on Ithaca’s then 70% owned Block 14/18b (Ithaca 52.33% post Dyas Transaction) to test a potential southern extension of the Athena oil pool. The well penetrated the Lower Cretaceous Leek sands, however, although the formation was found to be oil-bearing, it was of lower quality than is found in the Athena Reservoir and the well has been suspended pending evaluation and possible sidetracking and use in the Athena development scheme.

On July 21, 2008, the Corporation announced that it had successfully tested 28 degree API sweet oil at a stable rate of 2,330 barrels of oil per day (“bopd”) from its third well (14/18b-18) on the Athena project.

Following the dramatic decline in the oil price during the second half of 2008, the Athena development has been put on hold until such time as the oil price recovers and the Corporation sees a price correction in the oil services sector.

POST YEAR END EVENTS

Carna Well

On December 26, 2008 the Corporation commenced the drilling of the 43/21b-A well, to explore the Carna prospect in the UKCS Southern Gas Basin. The Carna prospect, operated by Venture North Sea Gas Limited, is a significant potential gas-bearing structure located in Block 43/21b, in which Ithaca Energy has a 29.9% interest, post the Dyas Transaction. Through a farm-out agreement, net dry hole costs to the Corporation were 22.4% of the total. The prospect lies adjacent the Garrow and Kilmar gas fields. On March 20, 2009, the Corporation confirmed that the Carna Gas well had been successfully tested at stabilised rates in line with expectations. Given that over 90% of the drilling was conducted post year end, no asset retirement obligation has been recorded in 2008 for this well.

Rig Deferral

The Ensco 92 rig was contracted to conduct the Jacky completion work, but due to the Ensco 92 rig working on the Carna Well and the planned test, agreement was reached with Ensco Offshore UK Limited to defer the commitment to the Ensco 92 for up to one year and Ithaca has contracted with Northern Offshore for the immediate mobilisation of the Energy Enhancer jack-up rig to conduct the Jacky completion. The deferred commitment, net to the Corporation, is \$4.05 million.

Foreign Exchange Contract

On March 11, 2009, the Corporation entered in to a “Window Forward Plus” contract with the Bank of Scotland to hedge circa 90% of the Corporation’s known future US Dollar to British Pound Sterling exchange rate exposure. The contract ensures that the Corporation, which incurs a substantial amount of its expenditure in British Pounds Sterling, is able to lock in a US\$/£ rate of no worse than 1.40:1.0 for a series of foreign exchange transactions throughout the year and yet continues to benefit from any additional strengthening of the US Dollar down to 1.29:1 (the “Trigger” rate). Any strengthening of the US\$/£ rate beyond the Trigger rate during any of the periods or “windows” between the transaction dates will lead to a rate of 1.40:1.00 being applied to that individual transaction. The contract covers \$49 million equivalent of British Pounds Sterling expenditure.

LIQUIDITY AND CAPITAL RESOURCES

Total cash inflow from financing activities in the year ended December 31, 2008 was \$112.5 million (2007 \$98.5 million); substantially as a result of the August share issue and the draw down of the RBS Facility.

During the year ended December 31, 2008 there was a cash outflow from operating activities of \$26.0 million compared to a cash outflow from operating activities of \$1.6 million for the corresponding period in 2007. This cash outflow is due largely to the operating loss from the Beatrice field, general and administrative costs, realized foreign exchange losses and changes in working capital, principally being an increase in stock resulting from the Beatrice acquisition. The Corporation expects to have a cash inflow from operating activities for the next year as Beatrice production continues and the Jacky field comes onstream. During 2008 there was a cash outflow from investing activities of \$155.8 million being principally the drilling of the Greater Beatrice Area and Athena wells.

Significant capital will be required to further the Corporation’s anticipated development activities in 2009 and 2010 and these are expected to be met through a combination of existing cash resources, cash flows from production and selective farm-outs. The Corporation is assuming that both the debt and equity markets are closed and therefore has budgeted for its expenditure program accordingly. The Corporation has an established track record in the equity markets and will be opportunistic in accessing further equity as and when such markets are once again open, however the Corporation is confident that it will be able to manage its portfolio in the absence of such funding for the foreseeable future.

The Corporation expects to continue to develop the existing licences held and to acquire new licences through participation in future licensing rounds and farm-ins from third parties.

CRITICAL ACCOUNTING ESTIMATES

Management is required to make judgments, assumptions and estimates in the application of generally accepted accounting principles that have a significant impact on the financial results of the Corporation.

Capitalized costs relating to the exploration and development of oil and gas reserves, along with estimated future capital expenditures required in order to develop proved reserves, are depleted and depreciated on a unit-of-production basis using estimated proved reserves.

The carrying value of property, plant and equipment is reviewed annually for impairment. Impairment occurs when the carrying value of the assets is not recoverable by the future undiscounted cash flows. The cost recovery ceiling test is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements could be material. The Corporation recognised an impairment of \$24.1 million on unproved oil and gas properties for the year 2008.

Liability recognition for asset retirement obligations associated with oil and gas wells are determined using estimated costs discounted based on the estimated life of the asset. These capitalized costs are amortized on a unit-of-production basis, consistent with depletion and depreciation. Over time, the liability is accreted up to the actual expected cash outlay to perform the abandonment and reclamation.

In order to recognize stock based compensation expense, the Corporation estimates the fair value of stock options granted using assumptions related to interest rates, expected life of the option, volatility of the underlying security and expected dividend yields. These assumptions may vary over time.

The determination of the Corporation's income and other tax liabilities requires interpretation of complex laws and regulations. Tax filings are subject to audit and potential reassessment after the lapse of considerable time. Accordingly, the actual income tax liability may differ significantly from that estimated and recorded on the financial statements.

REPORTING CURRENCY

The Beatrice field produces oil as will the Jacky field expected on production by the end of March, 2009. These assets will generate US Dollar revenues. As such, it is the intention of the Corporation to maintain the majority of its debt in US Dollars. The Corporation's debt as at year end is denominated exclusively in US Dollars.

The Corporation expects to receive 100% of its income over 2009 in US Dollars. Budgeted expenditure indicates that approximately 20% to 40% of 2009 expenditure is expected to be in US Dollars, the range being uncertainty over the currency for payment related to the planned Stella appraisal well. The foreign exchange contract entered in to on March 11, 2009 has increased the effective US Dollar weighting of known expenditures in 2009 to over 90%.

The corporation therefore believes that the US Dollar remains the appropriate reporting currency.

RISKS AND UNCERTAINTIES

The business of exploring for, developing and producing oil and natural gas reserves is inherently risky. There is substantial risk that the manpower and capital employed will not result in the finding of new reserves in economic quantities. There is a risk that the sale of reserves may be delayed due to processing constraints, lack of pipeline capacity or lack of markets. The price the Corporation will receive for its oil and natural gas production may fluctuate continuously and, for the most part, is beyond the Corporation's control.

The Corporation is exposed to financial risks including financial market volatility, fluctuation in

interest rates and various foreign exchange rates. Given the increasing development expenditure and operating costs in currencies other than US Dollars, the Board of the Corporation has agreed a hedging policy to mitigate foreign exchange rate risk on committed expenditure. On March 11, 2008 the Corporation entered in to a series of foreign exchange contracts in which it locked the price of approximately 90% of its known forward Pounds Sterling exposure through to the end of 2009.

The Corporation is dependent upon the production rates and oil price to fund the current development program as it has concluded that in the near term debt and equity markets are effectively closed. In the event that the markets remain closed to development finance the business will look to meet any liquidity shortfalls through the selected divestment of its portfolio. The forecast production budgeted to meet future expenditures is reliant upon the performance of the single Jacky well due on stream on or about the end of March 2009.

The Corporation is also subject to the risks associated with owning oil and natural gas properties, including environmental risks associated with air, land and water. The Corporation takes out market insurance to mitigate many of these operational, construction and environmental risks. In all areas of the Corporation's business there is competition with entities that may have greater technical and financial resources. There are numerous uncertainties in estimating the Corporation's reserve base due to the complexities in estimating the magnitude and timing of future production, revenue, expenses and capital.

For additional detail regarding the Corporation's risks and uncertainties, refer to the Corporation's most recent Annual Information Form filed on SEDAR at www.sedar.com.

RELATED PARTIES

A Director of the Corporation is a partner in Burstall Winger LLP who act as counsel for the Corporation. The amount of fees paid on an arms length basis to Burstall Winger LLP in 2008 were \$0.4 million (2007 \$0.4 million).

COMMITMENTS

The Corporation has the following financial commitments:

	2009	2010	2011	2012	2013
General & Administrative	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000
Exploration activities	\$ 245,400	\$ 245,400			
Inner Moray Firth	\$ 27,078,000				
Rig Commitment	\$ 4,049,955				
Exploration well		\$ 14,000,000			

The general and administrative commitment relates to the office lease. The exploration commitments cover license fees. The Inner Moray Firth commitment is for the liquidated damages payable to Talisman in the event that the Corporation returns the Beatrice facilities to Talisman within the first year of the lease period. The rig commitment relates to the deferral of the Ensco 92 rig in favour of the Energy Enhancer jack up to complete the Jacky well. The

exploration well is the remaining commitment to drill under the 24th Round awards. These commitments are expected to be met through existing cash balances, production from the Beatrice and Jacky fields and selective farm-outs.

DISCLOSURE CONTROLS AND PROCEDURES

Disclosure controls and procedures have been designed to ensure that information required to be disclosed by the Corporation is accumulated and communicated to management as appropriate to allow timely decisions regarding required disclosure. The Corporation's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of December 31, 2008, that the Corporation's disclosure controls and procedures are effective to provide reasonable assurance that material information related to the Corporation is made known to them by others within those entities. It should be noted that, while the Corporation's disclosure controls and procedures provide a reasonable level of assurance and that they are effective, they do not expect that the disclosure controls and procedures will prevent all errors and fraud. A control system, no matter how well conceived or operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met.

INTERNAL CONTROLS OVER FINANCIAL REPORTING

The Chief Executive Officer and Chief Financial Officer of the Corporation are responsible for designing internal controls over financial reporting or causing them to be designed under their supervision in order to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Canadian GAAP. We have assessed the design of our internal controls over financial reporting as the Corporation has grown throughout the year and during this process we have identified certain weaknesses in internal controls over financial reporting during the year which are as follows:

- Due to the limited number of staff at the Corporation, it is not possible to achieve complete segregation of duties; and
- Due to the size of the Corporation and the limited number of staff, the Corporation does not have the technical accounting expertise and knowledge to address all complex and non-routine accounting transactions that may arise.

Weaknesses in the Corporation's internal controls over financial reporting could result in a risk that a material misstatement may not be prevented or detected and having noted the weaknesses Management and the Board of Directors are committed to developing the systems of internal control over financial reporting to remove the weaknesses noted above and have therefore implemented a new financial software package that provides accurate monthly reporting on a project basis allowing Management to monitor actual results against budgeted or expected results in a timely manner. In addition, when complex accounting and technical issues arise during the preparation of the quarterly financial statements, external consulting expertise is engaged.

CHANGES IN ACCOUNTING POLICIES, INCLUDING INITIAL ADOPTIONS

Transition to International Financial Reporting Statements (“IFRS”)

In January 2006, the AcSB adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada are expected to converge with the International Financial Reporting Standards (“IFRS”) by 2011.

In anticipation of this conversion, the Corporation is ensuring that all finance staff are appropriately trained. Comparatives will be prepared during the 2010 financial year. In addition, the Corporation has recently installed new accounting software that is IFRS compliant. The management are confident that the Corporation will be properly prepared ahead of the transition date. It should also be noted that as the Corporation is operationally run from the United Kingdom, most financial staff are already familiar with IFRS reporting.

Goodwill and Intangible Assets

In February 2008, the AcSB issued Section 3064, “Goodwill and Intangible Assets” and amended Section 1000, “Financial Statement Concepts” clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized with assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. The Corporation is currently evaluating the impact these sections will have, if any, on the consolidated financial statements.

OUTSTANDING SHARE INFORMATION

As of March 26, 2009, there are 162,261,975 common shares of the Corporation outstanding and 172,956,475 common shares diluted. There are 10,694,500 options to purchase common shares outstanding.

Ithaca Energy Inc.

Consolidated Balance Sheets

(all amounts are US\$)

	December 31, 2008	December 31, 2007
ASSETS		
Current assets		
Cash and cash equivalents	\$ 26,943,802	\$ 96,214,707
Accounts receivable	12,879,389	3,048,284
Restricted cash (note 3)	12,305,014	-
Deposits, prepaid expenses and other	7,329,059	9,915,663
Inventory	1,289,032	-
	<hr/> 60,746,296	<hr/> 109,178,654
Long term receivable	400,617	-
Property, plant and equipment (net) (note 4)	296,523,448	116,963,890
	<hr/>	<hr/>
	\$ 357,670,361	\$ 226,142,544
<hr/>		
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable and accrued liabilities	\$ 41,057,033	\$ 17,949,326
Loan payable (note 6)	61,200,000	-
Long term liability on Beatrice acquisition (note 7)	4,137,413	-
Asset retirement obligation (note 5)	7,407,290	4,716,475
	<hr/>	<hr/>
	\$ 113,801,736	22,665,801
Shareholders' equity		
Share capital (note 8)	\$ 277,029,766	\$ 209,551,869
Contributed surplus (note 9)	5,126,285	1,765,333
Deficit	(38,287,426)	(7,840,459)
	<hr/> 243,868,625	<hr/> 203,476,743
	<hr/>	<hr/>
	\$ 357,670,361	\$ 226,142,544
<hr/>		
Commitments (Note 12)		

"Approved on behalf of the Board"

"John P. Summers"

Director

"Michael B. A. Nobbs"

Director

The accompanying notes to the consolidated financial statements are an integral part of these statements.

Ithaca Energy Inc.

Consolidated Statement of Net and Comprehensive Loss and Deficit

(all amounts are US\$)

Years ended December 31

	2008	2007
REVENUES		
Oil sales	2,472,106	-
Interest income	809,563	1,337,621
	<u>3,281,669</u>	<u>1,337,621</u>
EXPENSES		
General and administrative	4,822,640	4,650,493
Loan fee amortization (note 6)	3,668,891	-
Operating	4,587,834	-
Depletion, depreciation and accretion (note 4 & 5)	2,811,483	455,825
Loss/(Gain) on foreign exchange	11,938,414	(2,825,380)
Loss on Financial Instrument	1,777,181	-
Stock based compensation (note 8d)	3,529,252	1,109,396
Interest and bank charges	245,483	275,858
	<u>33,381,178</u>	<u>3,666,192</u>
Loss before income taxes	30,099,509	2,328,571
Current Income Taxes	347,458	-
Net and comprehensive loss after income taxes	30,446,967	,2,328,571
Deficit, beginning of year	7,840,459	5,511,888
Deficit, end of year	<u>38,287,426</u>	<u>7,840,459</u>
Net and comprehensive loss per share (basic and diluted) (note 10)	0.23	0.02

The accompanying notes to the consolidated financial statements are an integral part of these statements.

Ithaca Energy Inc.

Consolidated Statements of Cash Flows

Years ended December 31

(all amounts are US\$)

	2008	2007
CASH PROVIDED BY (USED IN):		
OPERATING ACTIVITIES:		
Net loss	(30,446,967)	\$ (2,328,571)
Items not affecting cash		
Depletion, depreciation and accretion	2,811,483	455,825
Loan fee amortisation	3,668,891	-
Loss on financial instrument	1,777,181	-
Stock based compensation (note 8d)	3,360,952	1,109,396
	(18,828,460)	(763,350)
Changes in Non-Cash Working Capital	(21,956,849)	1,461,776
	(40,785,309)	698,426
FINANCING ACTIVITIES:		
Proceeds from issuance of shares	71,050,134	103,620,335
Share issue costs (note 8b)	(3,740,537)	(5,078,594)
Restricted cash (note 3)	(12,305,014)	-
Loan (note 6)	61,200,000	-
Loan issue costs (note 6)	(3,668,891)	-
	112,535,692	98,541,741
INVESTING ACTIVITIES:		
Oil and natural gas properties	(180,595,707)	(72,670,080)
Office furniture and equipment	(693,400)	(221,571)
	(181,289,107)	(72,891,651)
Changes in Non-Cash Working Capital relating to investing activities	25,478,840	20,835,327
	(155,810,267)	(52,056,324)
Loss/(Gain) on foreign exchange	14,788,979	(2,340,743)
INCREASE/ (DECREASE) IN CASH AND CASH EQUIVALENTS	(69,270,905)	\$ 44,843,100
Cash and cash equivalents, beginning of year	\$ 96,214,707	\$ 51,371,607
Cash and cash equivalents, end of year	\$ 26,943,802	\$ 96,214,707

The accompanying notes to the consolidated financial statements are an integral part of these statements.

Ithaca Energy Inc.

Notes to the Consolidated Financial Statements **Year ended December 31, 2008 and December 31, 2007**

1. NATURE OF OPERATIONS

Ithaca Energy Inc. (the "Corporation" or "Ithaca Energy"), incorporated in Alberta on April 27, 2004 and its wholly-owned subsidiary Ithaca Energy (UK) Limited, incorporated in Scotland are a publicly traded group of companies involved in the exploration and development of oil and gas in the North Sea. The Corporation's shares are listed on the TSX Venture Exchange in Canada and the London Stock Exchange's AIM in the United Kingdom under the symbol "IAE".

Since May 2004, the Corporation has been evaluating the resource potential of certain oil and natural gas exploration properties and is considered to be in its development stage of operations. The recoverability of amounts shown for oil and natural gas properties is dependent upon the determination of economically recoverable reserves.

2. SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation

The consolidated financial statements of the Corporation include the accounts of Ithaca Energy Inc. and its wholly-owned subsidiary Ithaca Energy (UK) Limited. All inter-company transactions and balances have been eliminated.

Use of Estimates

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. The amounts recorded for depreciation, asset retirement obligation, future income taxes, and stock based compensation are based upon estimates, as are assumptions used in the ceiling test. Actual results could differ from those estimates.

Cash and Cash Equivalents

For the purpose of cash flow statements, cash and cash equivalents include investments with an original maturity of three months or less.

Restricted Cash

Cash that is held for security for bank issued Letters of Credit and bank guarantees are reported in the balance sheet and cash flow statements separately. If the expected duration of the restriction is less than twelve months then it is shown in current assets.

Inventory

Inventories of materials and supplies are stated at the lower of cost and net realizable value. Cost is determined on the first-in, first out method.

Financial Instruments

The Corporation's financial instruments consist of cash, accounts receivable and accounts payable and accrued liabilities. It is management's opinion that the Corporation is not exposed to significant interest, currency or credit risk arising from its financial instruments and that their fair values approximate their carrying values.

Foreign Currency Translation

Items included in the financial statements are measured using the currency of the primary economic environment in which the Corporation operates (the 'functional currency'). The consolidated financial statements are presented in United States Dollars, which is the Corporation's and Ithaca Energy (UK) Limited's functional and presentation currency. Foreign currency transactions are translated into the functional currency under the temporal method using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the income statement.

Property, Plant and Equipment

(a) Oil and Natural Gas Operations:

The Corporation follows the full cost method of accounting for exploration and development expenditures whereby all costs relating to the acquisition, exploration and development of oil and natural gas reserves are capitalized. Such costs include lease acquisitions, geological and geophysical data, lease rentals on undeveloped properties, drilling both productive and non-productive wells, production equipment, and overhead charges directly related to acquisition, exploration and development activities. Proceeds received from disposals of properties and equipment are credited against capitalized costs unless the disposal would alter the rate of depletion and depreciation by more than 20 percent, in which case a gain or loss on disposal is recorded. In addition, proceeds received from the sale of future royalties are credited to oil and gas properties.

All costs of acquisition, exploration and development of oil and natural gas reserves, associated tangible plant and equipment costs, and estimated costs of future development of proved developed reserves are depleted and depreciated by the unit of production method based on estimated gross proved reserves before royalties as determined by independent evaluators. Natural gas reserves are converted to equivalent units using their relative energy content of six thousand cubic feet of natural gas to one barrel of oil. The costs of acquiring and evaluating unproved properties are excluded from costs subject to depletion. These properties are assessed periodically to ascertain whether impairment has occurred. When proved reserves are assigned or the property is considered to be impaired, the cost of the property or the amount of the impairment is added to the costs subject to depletion.

Petroleum and natural gas assets are evaluated annually to determine whether the costs are recoverable. The costs are assessed to be recoverable if the sum of the undiscounted cash flows expected from the production of proved reserves plus the lower of cost and market value of unproved properties exceed the carrying value of the petroleum and natural gas assets. If the carrying value of the petroleum and natural gas assets is not assessed to be recoverable, an impairment loss is recognized to the extent that the carrying value exceeds the sum of the discounted cash flows expected from the production of proved and probable reserves and the lower of cost and market value of unproved properties. The cash flows are estimated using future product prices and costs and are discounted using the risk-free interest rate.

(b) Furniture and Office Equipment:

Computer and office equipment is recorded at cost and depreciated over its estimated useful life on a straight-line basis over three years. Furniture and fixtures are recorded at cost and depreciated over their estimated useful lives on a straight-line basis over five years.

Capitalized Interest

Interest costs associated with major development projects are capitalized until the project is substantially completed. These costs are subsequently depleted together with the related assets.

Joint Interest Operations

Substantially all of the Corporation's oil and natural gas activities are carried out jointly with others. These consolidated Financial Statements reflect only the Corporation's proportionate interest in such activities.

Asset Retirement Obligation

The Corporation records the present value of legal obligations associated with the retirement of long-lived tangible assets, such as producing well sites and processing plants, in the period in which they are incurred with a corresponding increase in the carrying amount of the related long-lived asset. In subsequent periods, the asset estimate obligation is adjusted for the passage of time and any changes in the estimated amount or timing of the settlement of the obligations. The carrying amounts of the long-lived assets are depleted using the unit of production method. Actual costs to retire tangible assets are deducted from the liability as incurred.

Revenue Recognition

Oil revenues associated with the sale of the Corporation's crude oil are recognized when title passes to the customer. The costs associated with the delivery, including operating and maintenance costs and transportation expenses are recognized in the same period in which the related revenue is earned and recorded.

Stock based Compensation

The Corporation has a stock based compensation plan as described in note 8. Stock based compensation expense is recorded in the statement of comprehensive loss and deficit for all options granted in the year, with a corresponding increase recorded as contributed surplus. Compensation expense is based on the estimated fair values at the time of the grant and the expense is recognized over the vesting period of the options. Upon the exercise of the stock options, consideration paid together with the amount previously recognized in contributed surplus is recorded as an increase in share capital. In the event that vested options expire unexercised, previously recognized compensation expense associated with such stock options is not reversed. In the event that options are cancelled, previously recognized compensation expense associated with the unvested portion of such stock options is reversed.

Earnings per Share

Basic earnings per common share are calculated on the net earnings using the weighted average number of shares outstanding during the fiscal period. Diluted earnings per share information is calculated using the treasury stock method which assumes that proceeds obtained upon exercise of options and warrants would be used to purchase common shares at the average market price for the period. No adjustment to diluted earnings per share is made if the result of this calculation is anti-dilutive.

Income Taxes

Income taxes are accounted for using the asset and liability method of tax allocation. Future income taxes are recognized for the future income tax consequences attributable to differences between the carrying values of assets and liabilities and their respective income tax bases. Future income tax assets and liabilities are measured using substantively enacted income tax rates expected to apply to taxable income in the years in which temporary differences are expected to be recovered or settled. The effect on future income tax assets and liabilities of a change in rates is included in earnings in the period of the enactment date. Future income tax assets are recorded in the consolidated financial statements if realization is considered more likely than not.

Change in Accounting Policies

(a) Financial Instruments Disclosure and Presentation

In December 2006, the CICA approved Handbook Section 3862 "Financial Instruments – Disclosures", and Handbook Section 3863 "Financial Instruments Presentation". The objective of Section 3863 is to require entities to provide disclosures in their financial statements that enable users to evaluate both the significance of financial instruments for the entity's financial position and performance and the nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the balance sheet date, and how the entity manages those risks. The purpose of Section 3862 is to enhance financial statement users' understanding of the significance of financial instruments to an entity's financial position, performance and cash flows. These sections apply to interim and annual financial statements relating to fiscal years beginning on or after October 1, 2007. The Corporation has adopted the new disclosure requirements in 2008. The two sections result in the additional disclosures set out below. There have been no significant changes from the previous year to the Corporation on its exposure to risks and management's objectives, policies and process to manage the market risks outlined below.

The Corporation has identified that it is exposed principally to the following areas of market risk.

i) Commodity Risk

Commodity price risk related to crude oil prices is one of the Corporation's most significant market risk exposures. Crude oil prices and quality differentials are influenced by worldwide factors such as OPEC actions, political events and supply and demand fundamentals. The Corporation's expenditures are subject to the effects of inflation and prices received for the product sold are not readily adjustable to cover any increase in underlying expenses from inflation. The Corporation may periodically use different types of derivative instruments to manage its exposure to price volatility, thus mitigating fluctuations in commodity-related cash flows. The Corporation currently has no derivative instruments in place.

Fluctuations in oil price may impact the economic recoverability of reserves thereby resulting in impairment. This is one of the factors considered when the impairment test is conducted at year end or following any significant event. If the oil price had been lower by \$5 per barrel in 2008 then the loss for the year would have been higher by \$293,600.

ii) Interest Risk

The Corporation uses floating rate debt to finance its developments and operations, which is then fixed as required by the debt facility terms.

The Corporation is exposed to interest rate risk to the extent that LIBOR may fluctuate. The Corporation's debt will be denominated in U.S. dollars ("USD") or British Pounds Sterling ("GBP") as appropriate.

The Corporation will evaluate its annual forward cash flow requirements on a rolling monthly basis. Accordingly, individual facility amounts utilized and related interest terms will vary. If the interest rate had been higher by 1% then the interest charged in 2008 would have been \$600,000 higher.

iii) Foreign Exchange Rate Risk

The Corporation is exposed to foreign exchange risks to the extent it transacts in various currencies, while measuring and reporting its results in USD. The exposure to foreign exchange risk is partly mitigated since debt financing is in USD. Since time passes between the recording of a receivable or payable transaction and its collection or payment, the Corporation is exposed to gains or losses on non USD amounts and on balance sheet translation of monetary accounts denominated in non USD amounts upon spot rate fluctuations from quarter to quarter.

The Corporation believes that its foreign exchange risk is mitigated in that future revenues and interest expense and a portion of its operating and exploration costs are largely transacted in USD.

As at December 31, 2008, the Company had no contracts outstanding.

iv) Credit Risk

The Corporation's accounts receivable with customers in the oil and gas industry are subject to normal industry credit risks and are unsecured.

The Corporation routinely has cash on deposit and only places these funds on deposit with financial institutions with a credit rating of A+ or better.

The Corporation assesses partners' and customer's credit worthiness before entering into farm-in or joint venture agreements. In the past, the Corporation has not experienced credit loss in the collection of accounts receivable. As the Corporation's exploration, drilling and development activities expand with existing and new joint venture partners, the Corporation will continue to assess and continuously update its management of associated credit risk and related procedures.

The Corporation regularly monitors all customer receivable balances outstanding in excess of 90 days. At December 31, 2008 there is one debtor that is over 90 days and management has agreed with the debtor that the amount can be paid in 12 equal installments commencing April 2009. Accordingly, there is no allowance for doubtful accounts on accounts receivable. The amount over 90 days is \$1,201,850 and of this amount \$400,617 has been classified as a Long term receivable.

v) Liquidity Risk

Liquidity risk includes the risk that as a result of its operational liquidity requirements the Corporation will not have sufficient funds to settle a transaction on the due date. The Corporation manages liquidity risk by maintaining adequate cash reserves, banking facilities, and by considering medium and future requirements by continuously monitoring forecast and actual cash flows. The Corporation considers the maturity profiles of its financial assets and liabilities. As at December 31, 2008, substantially all accounts payable are current.

b) Inventory

Effective January 1, 2008 the Corporation prospectively adopted Section 3031, "Inventories" which stipulates that major spare parts and standby equipment that are not in use should be included in property plant and equipment, and also provides more guidance on the measurement and disclosure requirements for inventory that is at the lower of cost and net realizable value. There has been no impact on the Corporation's financial statements as a result of adopting this policy.

c) Capital Disclosures

Effective January 1, 2008 the Corporation has adopted Handbook Section 1535, "Capital Disclosures" which requires entities to disclose their objectives, policies and processes for managing capital, and in addition, whether the entity has complied with any externally imposed capital requirements.

The Corporation's objectives when managing capital are:

- to safeguard the Corporation's ability to continue as a going concern;
- to maintain balance sheet strength and optimal capital structure, while ensuring the Corporation's strategic objectives are met; and
- to provide an appropriate return to shareholders relative to the risk of the Corporation's underlying assets.

In the management of capital, the Corporation includes shareholders' equity, working capital and interest bearing debt. Shareholders' equity includes share capital, contributed surplus, retained earnings or deficit and other comprehensive income.

The Corporation maintains and adjusts its capital structure based on changes in economic conditions and the Corporation's planned requirements. The Board of Directors reviews the Corporation's capital structure and monitors requirements. The Corporation may adjust its capital structure by issuing new equity and/or debt, selling and/or acquiring assets, and controlling capital expenditure programs.

The Board sets guidelines for the management of the Corporation's capital. The Corporation monitors its capital structure using the debt-to-equity ratio and other benchmark measures at the consolidated group level.

(in \$ millions)	December 31, 2008	December 31, 2007
Debt	\$ 61.2	\$ -
Equity	243.9	203.5
Debt as a % of Equity	25%	0%

As at December 31, 2008, there are externally imposed debt covenants with respect to the Corporation's capital structure. These covenants relate to the \$61.2 million loan facility with Dyas (UK) Limited. All covenants have been complied with.

There have been no significant changes from the previous year to management's objectives, policies and processes to manage capital or to the components defined as capital.

Other Pronouncements

In February 2008, the AcSB issued Section 3064, "Goodwill and Intangible Assets" and amended Section 1000, "Financial Statement Concepts" clarifying the criteria for the recognition of assets, intangible assets and internally developed intangible assets. Items that no longer meet the definition of an asset are no longer recognized as assets. The standard is effective for fiscal years beginning on or after October 1, 2008 and early adoption is permitted. The Corporation is currently evaluating the impact these sections will have, if any, on the consolidated financial statements.

In January 2006, the AcSB adopted a strategic plan for the direction of accounting standards in Canada. Accounting standards for public companies in Canada are required to converge with the International Financial Reporting Standards ("IFRS") by 2011. The Corporation is in initial stages of assessing IFRS and its impact on the consolidated financial statements.

3 RESTRICTED CASH

Restricted cash of \$10,419,840 is held by the Bank of Scotland as cash security for a Letter of Credit that Ithaca Energy (UK) Limited provided to the UK Department of Energy and Climate Control when it was granted Field Development Plan approval for the Jacky Field. The cash will be restricted until July 2009 when the requirement for the Letter of Credit will be reviewed.

Restricted cash of \$1,855,174 is held by the Bank of Scotland as cash security for a Bank Guarantee that Ithaca Energy (UK) Limited provided to the Crown Estate when it was granted Field Development Plan approval for the Jacky Field. The cash will be restricted until November 2009 when the requirement for the bank guarantee will be reviewed.

4 PROPERTY, PLANT AND EQUIPMENT

	December 31, 2008	December 31, 2007
Oil and natural gas properties	\$ 297,918,747	\$ 116,675,835
Less accumulated depletion	(2,178,728)	-
	<u>295,740,019</u>	<u>116,675,835</u>
Office furniture and equipment	1,171,222	477,822
Less accumulated depreciation and amortization	(387,793)	(189,767)
	<u>783,429</u>	<u>288,055</u>
	<u>\$ 296,523,448</u>	<u>\$ 116,963,890</u>

During November 2008 the Corporation acquired a producing asset (Beatrice Field) and consequently began recognising depletion expense amounting to \$2,178,728 by December 31, 2008 (2007 – NIL). At December 31, 2008, oil and natural gas properties included \$272.1 million (2007 - \$68.7 million) relating to proved properties and \$24.6 million (2007 \$48.0 million) relating to unproved properties. During 2008, the Corporation capitalized \$7.6 million (2007 - \$4.1 million) of overhead directly related to exploration, appraisal and development activities. Future development costs for the proved oil and gas properties are forecast to be approximately \$334.7million.

At December 31, 2008 included in the above balance is an amount of \$1.7 million (2007: NIL) relating to capitalized interest.

A ceiling test was performed for both years and there was no impairment of proved oil and gas properties. There was an impairment of \$24.1 million (2007: NIL) relating to unproved oil and gas properties and this has been added to the proved oil and gas properties cost pool which is depleted over unit of production based on proved reserves .

The forecasted future prices used in the ceiling test were as follows:

	Oil Reference Price (\$/bbl)
2009	51.73
2010	61.37
2011	64.66
2012	72.11
2013	83.05

Acquisitions

In August 2008 Ithaca completed the acquisition of a 66.67% working interest in the Stella and Harrier Shallow discoveries which lie in United Kingdom Continental Shelf Block 30/6 Rest of Block (Chalk Layers and Younger) ("Stella"), for an initial consideration of \$15 million from joint owners Shell U.K. Limited ("Shell") and Esso Exploration and Production UK Limited ("Esso"). A further payment of \$15 million will become payable to Shell and Esso at the time of Field Development Plan approval and proceeds from Ithaca's share of production will be subject to a 5% overriding royalty.

In November 2008 the Corporation completed its transaction to lease the Beatrice assets resulting in immediate access to production averaging up to 2,000 bopd and providing the export route for the Jacky crude. The lease premium was \$10 million plus \$0.8 million in acquired stock.

Disposal

On 31 October, 2008 Ithaca entered into a Sale and Purchase Agreement (the "Dyas Transaction") with Dyas UK Limited ("Dyas") for the sale of a portion of its interests in all of its oil and gas licences and the provision of a convertible loan facility. The Dyas Agreement provided that Dyas would purchase 25.25% of Ithaca's interests in all assets owned by the Company as the date of the transaction for the consideration of £40 million (approximately US\$65.6 million) cash effective November 1, 2008. Dyas advanced this sum to Ithaca as a loan until closing of the transaction at which time the consideration would be repaid and the loan would become immediately repayable.

In addition, Dyas provided Ithaca with a senior secured loan (the "Dyas Facility") with which to redeem in full the fully drawn Royal Bank of Scotland US\$60 million Predevelopment Facility. The Dyas Facility has a margin over US Dollar Libor of 4.5% and an initial term of two years. The loan is extendable by Dyas in two one-year tranches should the oil price average less than US\$60 per barrel in the previous year, giving Ithaca an extended credit facility.

Dyas UK Limited has the option at any time during the subsequent two years to acquire an additional 15.15% of the Corporation's portfolio held as at 1 November, 2008, for a consideration of \$61.2 million, as adjusted for working capital movements in the intervening period. In the event that the option is exercised, then the \$61.2 million outstanding loan facility would become immediately due and payable, and the consideration would then be applied to meet this obligation in full. On December 17, 2008 the Dyas Transaction partially completed with all the interests other than that relating to the Stella field having been transferred. As a consequence the consideration paid on the partial completion was adjusted to £35 million with the balance of £5 million payable upon the transfer of the Stella interest. The transfer of the interest in the Stella property is expected to complete in late March or early April 2009.

The 20% (6.7% expected unitization) interest in the Barbara gas field was disposed of on November 14, 2008 as non core to Ithaca. The sale proceeds were \$8.25 million.

5 ASSET RETIREMENT OBLIGATIONS

The total future asset retirement obligation was estimated by management based on its net ownership interest in all wells and facilities, estimated costs to reclaim and abandon wells and facilities and the estimated timing of the costs to be incurred in future periods. The Corporation estimates its total undiscounted asset retirement obligations to be \$8,029,898 as at December 31, 2008. The Corporation uses a credit adjusted risk free rate of 8.0 percent based upon the Corporation's current cost of borrowing and an inflation rate of 2.5 percent over the varying lives (1 to 3 years) of the assets to calculate the present value of the asset retirement obligation. Upon the acquisition of the Beatrice Field in November 2008 the Corporation did not assume the decommissioning liabilities

The following table provides a reconciliation of the Company's total discounted asset retirement obligations:

	2008	2007
Balance, beginning of year	\$ 4,716,475	\$ 1,513,000
Liabilities incurred	4,493,350	2,645,184
Accretion	434,730	362,948
Liabilities disposed of	(2,237,265)	-
Revision of estimates	-	195,343
Balance, end of year	\$ 7,407,290	\$ 4,716,475

6 LOAN PAYABLE

The Corporation had the following loan facility in place with Dyas (UK) Limited

	Balance Available	Outstanding as at December 31, 2008	Interest Rate per annum	Maturity Date
Loan Facility	\$61,200,000	\$61,200,000	LIBOR+4.5%	October 31, 2010

Arrangement and redemption fees for the previous RBS Loan Facility were \$3,668,891 and have been fully amortized in 2008.

The Loan Facility is collateralized by a bond and floating charge over the assets of Ithaca Energy (UK) Limited ("the Borrower") and a share pledge by Ithaca Energy Inc over its share in the Borrower.

The Financial covenants relating to the Pre-development Facility are

1. The ratio of the Net Present Value of the Jacky and Athena fields to the amount outstanding is not less than 1.2 : 1
2. The Net Assets of Ithaca Energy Inc are not less than \$100,000,000 at any time,

There were no violations of the covenants in the period.

7 LONG TERM LIABILITY ON BEATRICE ACQUISITION

On completion of the acquisition of the Beatrice Facilities on November 10, 2008 there were 75,000 barrels of oil in an oil storage tank at the Nigg Terminal. This volume of oil is required to be in the storage tank when the Beatrice Facilities are re-transferred. This volume of oil was valued at the price on the forward oil price curve at the expected date of re-transfer and will be subject to revaluation at each financial quarter. The expected date of re-transfer is likely to be more than three years.

8. SHARE CAPITAL

(a) Authorized

The Corporation has authorized share capital of an unlimited number of common shares of no par value.

Authorized
Unlimited number of Voting Common Shares without nominal or par value
Unlimited number of Preferred Shares issuable in series

(b) Issued

The issued share capital is as follows:

Issued	Number	Amount
Balance December 31, 2006	82,904,475	\$ 110,782,103
Issued for cash – November issue	27,400,000	101,837,132
Issued for cash – options exercised	1,627,500	1,783,203
Transfer from Contributed Surplus on options exercised		228,025
Share issue costs	-	(5,078,594)
Balance December 31, 2007	111,931,975	\$ 209,551,869
Issued for cash – options exercised	330,000	759,599
Issued for cash	50,000,000	70,290,535
Share issue costs		(3,740,537)
Transfer from Contributed Surplus on options exercised		168,300
Balance December 31, 2008	162,261,975	\$ 277,029,766

On August 11, 2008 the Corporation successfully closed an equity offering via a fully marketed deal. Gross proceeds were C\$75 million through the issue of 50 million common shares at a price of C\$1.50 per common share.

(c) Stock Options

The Corporation has a stock option plan, approved by shareholders on April 12, 2006, for directors, officers, employees and consultants which provides for the granting of options to acquire common shares. At December 31, 2008, there were 16,226,197 (2007 8,290,447) common shares authorized for issuance under the plan.

At December 31, 2008 10,694,500 stock options to purchase common shares were outstanding, having an exercise price range of \$0.20 (C\$0.25) and \$1.69 to \$2.99 (C\$1.80 to C\$3.65) per share with an average remaining contractual life of 1.89 years. The Corporation's share price at December 31, 2008 was C\$ 0.31 and therefore only 3,444,500 options out of 10,694,500 options outstanding were in the money.

Changes to the Corporation's stock options are summarized as follows:

	2008		2007	
	Number of Options	Wt. Avg. Exercise Price *	Number of Options	Wt. Avg. Exercise Price *
Balance, Beginning of Year	4,330,000	\$ 2.01	4,052,500	\$ 1.64
Granted	7,224,500	1.82	2,365,000	2.26
Cancelled	(530,000)	1.97	(460,000)	2.28
Exercised	(330,000)	2.07	(1,627,500)	1.06
Balance, End of Year	10,694,500	\$ 1.89	4,330,000	\$ 2.01
Exercisable, End of Year	2,613,333	\$ 1.91	2,852,500	\$ 1.84

*The weighted average exercise price has been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

The following is a summary of stock options outstanding as at 31 December, 2008.

Range of Exercise Price	Options Outstanding		
	Number of Options	Wt. Avg. Life (Years)	Wt. Avg. Exercise Price *
\$0.20 (C\$0.25)	3,444,500	4.92	\$ 0.20
\$0.90	450,000	0.17	0.90
\$1.69 (C\$1.80)	600,000	4.67	1.69
\$2.07 - \$2.99 (C\$2.-2 - C\$3.65)*	6,200,000	2.51	2.85
	10,694,500	3.31	\$ 1.89

*The exercise price and the weighted average exercise price has been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance.

The following is a summary of stock options exercisable at 31 December, 2008.

Options Exercisable			
Range of Exercise Price	Number of Options	Wt. Avg. Life (Years)	Wt. Avg. Exercise Price *
\$0.90	450,000	0.17	0.90
\$2.07 - \$2.99 (C\$2.-2 – C\$3.65)*	2,163,333	0.73	3.09
	2,613,333	0.64	\$ 1.91

*The exercise price and the weighted average exercise price has been converted into U.S. dollars based on the foreign exchange rate in effect at the date of issuance

On January 30, 2008 the Corporation's Board granted 1,125,000 options at an exercise price of C\$3.65 to employees. On February 15, 2008 the Corporation's Board granted 2,590,000 options at an exercise price of C\$3.65 to directors and employees. On September 2, 2008 the Corporation's Board granted 600,000 options at an exercise price of C\$1.80 to employees. On December 8, 2008 the Corporation's Board granted 3,444,500 options at an exercise price of C\$0.25 to directors and employees

At December 31, 2008 10,694,500 stock options to purchase common shares were outstanding, having an exercise price range of \$0.90 (C\$1.06) and \$1.68 to \$3.70 (C\$1.80 to C\$3.65) per share.

(d) Stock-Based Compensation

Options granted are accounted for using the fair value method. The compensation cost charged against earnings for stock options granted in 2008 was \$3,529,252 (2007 - \$1,109,396) The fair value of each stock option grant was estimated at the date of grant, using the Black-Scholes option pricing model with the following assumptions:

	2008	2007
Risk free interest rate	3.12	4.25
Expected dividend yield	0%	0%
Expected stock volatility	154%	77%
Expected life	5 years	3 years
Weighted Average Fair Value	\$ 0.92	\$ 1.13

9. CONTRIBUTED SURPLUS

	2008	2007
Balance, beginning of year	\$ 1,765,333	\$ 883,962
Issue of Stock Options	3,529,252	1,109,396
Transfer to Share Capital on exercise of options	(168,300)	(228,025)
Balance, end of year	\$ 5,126,285	\$ 1,765,333

10. PER SHARE AMOUNTS

The weighted average number of shares outstanding during 2008 was basic 131,633,833 (2007 87,742,543) and diluted 138,513,009 (2007 92,459,071). The difference between basic and diluted shares relates to outstanding stock options. For the purpose of calculating the diluted net loss per share for the year ended December 31, 2007 and the year ended December 31, 2008, incremental shares from assumed exercise of stock options are not included due to the anti-dilutive effect.

11. FUTURE INCOME TAXES

The provision for future income taxes differs from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to earnings before taxes. The reasons for these differences are as follows:

	2008	2007
Loss before taxes	\$30,099,509	\$ 2,328,571
Enacted tax rate	29.50%	32.12%
Computed income taxes at the enacted rate	8,879,355	747,937
Expenses not deductible for tax purposes	30,136,136	(356,338)
Recognition of previously unrecognised assets	965,193	556,706
Difference in foreign tax rates	24,810,622	(75,809)
Change in tax rates	(928,858)	(114,767)
Change in tax rates on opening	(58,962)	-
Change in valuation allowance	(63,803,486)	(757,728)
Total	\$ -	\$ -

At December 31, 2008, the Corporation had estimated future tax assets as follows:

	2008	2007
Future Tax Assets		
Non-capital losses	\$ 144,955,846	\$ 2,539,362
Share issue costs	2,906,756	2,975,917
Fixed assets	(134,013,428)	-
General Provision	2,594,348	-
Valuation Allowance	(16,443,522)	(5,515,299)
Total	\$ -	\$ -

12. COMMITMENTS

The Corporation has the following financial commitments:

	2009	2010	2011	2012	2013
General & Administrative	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000	\$ 320,000
Exploration activities	\$ 245,400	\$ 245,400			
Inner Moray Firth	\$ 27,078,000				
Rig Commitment	\$ 4,049,955				
Exploration well		\$ 14,000,000			

13. RELATED PARTY TRANSACTIONS

A Director of the Corporation is a partner in Burstall Winger LLP who acts as legal counsel for the Corporation. The amount of fees, measured at the exchange amount, paid to Burstall Winger LLP in the period to December 31, 2008 was \$384,925 (2007 - \$387,000). The balance outstanding at December 31, 2008 was \$:NIL (2007 - \$176,037).

14 FAIR VALUES OF FINANCIAL ASSETS AND LIABILITIES

Financial instruments of the Company consist mainly of cash and cash equivalents, receivables, payables, loans and financial derivative contracts, all of which are included in these financial statements. At December 31, 2008, the classification of financial instruments and the carrying amounts reported on the balance sheet and their estimated fair values are as follows:

Classification	Carrying Amount	Fair Value
Cash and cash equivalents	26,943,802	26,943,802
Accounts receivable - current	12,879,389	12,879,389
Accounts receivable – long term	400,617	400,617
Accounts payable	41,057,033	41,057,033
Loans	61,200,000	61,200,000
Long Term Liability	4,137,413	4,137,413
Total	146,618,254	146,618,254

The carrying value of the long term receivable is approximately equal to the fair value.

15. SUPPLEMENTAL INFORMATION

	2008	2007
Interest paid during the year	\$ 3,311,177	\$ 189
Income taxes paid during the year	\$ 116,464	\$ -

16. SUBSEQUENT EVENTS

Exchange Rate Contract

On March 11, 2009, the Corporation entered in to a "Window Forward Plus" contract with the Bank of Scotland to hedge circa 90% of the Corporation's known future US Dollar to British Pound Sterling exchange rate exposure. The contract ensures that the Corporation, which incurs a substantial amount of its expenditure in British Pounds Sterling, is able to lock in a US\$/£ rate of no worse than 1.40:1.0 for a series of foreign exchange transactions throughout the year and yet continues to benefit from any additional strengthening of the US Dollar down to 1.29:1 (the "Trigger" rate). Any strengthening of the US\$/£ rate beyond the Trigger rate during any of the periods or "windows" between the transaction dates will lead to a rate of 1.40:1.00 being applied to that individual transaction. The contract covers \$49 million equivalent of British Pounds Sterling expenditure.